Supreme Court, U.S.
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No. 95-1749

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

EDWARD F. HEIL,

Petitioner,

vs.

BENNETT S. LEBOW, ROBERT DAVIES, WILLIAM WEKSEL, and BROOKE PARTNERS, L.P.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION

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COUNTER-STATEMENT OF THE QUESTION PRESENTED

Whether the district court correctly granted summary judgment dismissing petitioner's securities fraud claim, where, after respondents pointed out the absence of evidence to support elements of the claim on which petitioner would bear the burden of proof at trial, petitioner (i) failed to adduce evidence sufficient to establish the existence of the alleged misrepresentations and omission and (ii) failed to offer any evidence regarding the existence of an alleged undisclosed plan or scheme, relying in this respect solely on the conclusory allegations of his complaint.

STATEMENT UNDER RULE 29.6

BGLS Inc. is the successor to Brooke Partners, L.P., a respondent herein. BGLS Inc. is a wholly-owned subsidiary of Brooke Group Ltd., a New York Stock Exchange listed and traded company. The following are nonwholly owned indirect subsidiaries or affiliates of BGLS Inc.: New Valley Corporation; Liggett-Ducat Ltd.; Ladenburg, Thalmann Group Inc.; Thinking Machines Corporation; and Empresa Brasileira de Aeronautica, S.A.

STATUTES OR REGULATIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 promulgated thereunder by the Securities and Exchange Commission, 17 C.F.R. § 240.10b-5, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:
>
> (1) To employ any device, scheme, or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

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COUNTER-STATEMENT OF THE CASE

In 1987, in a corporate restructuring conceived and implemented by respondent Bennett S. LeBow ("LeBow"), the financially distressed old Western Union Corporation ("Old WUC") and Western Union Telegraph Company, Inc. ("WUTCO") were merged to form new Western Union Corporation ("WUC").[1] LeBow helped raise $500 million of debt financing for the restructuring, and a company which he controlled contributed $25 million in new equity to WUC. In return, that company -- a predecessor-in-interest to respondent Brooke Partners, L.P. -- received a single Class B Common

[1] WUC changed its name to New Valley Corporation in 1991.

Share of WUC, a sort of "super common" share that was convertible in certain circumstances into as much as 100 million shares, or 51%, of ordinary WUC common stock. Until converted, the Class B Common Share voted and received dividends together with the ordinary common shares, as if already converted into ordinary common shares. (A-3 to A-4)[2]

The prospectus and proxy statement disseminated by Old WUC and WUTCO in connection with their restructuring fully disclosed the circumstances under which the Class B Common Share could be converted, involving a single condition precedent (the "Conversion Test"), as follows:

> The holders of the Class B Common Share shall have the right at their option, to convert such share into Common Shares commencing on the January 1 immediately following the end of the fiscal year in which [WUC] achieves one full fiscal year of net income in excess of preferred dividend requirements (as reflected in the audited year-end published financial statements of [WUC] computed in accordance with generally accepted accounting principles); provided, however, that the Class B Common Share may not be so converted prior to July 2, 1989, and subject further to the following terms and conditions . . . .

(A-4 to A-5) The Conversion Test was satisfied in 1990, and the Class B Common Share was converted in 1991 into 79,399,254 common shares. (A-5)

Petitioner, Edward F. Heil ("Heil"), a common stockholder of WUC who acquired his shares in open-market transactions from May 1989 through January 1990, filed this action in December 1990 alleging, *inter alia*, violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 12 of the Illinois Securities Law of 1953, as

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[2] References in this form are to petitioner's Appendix of selected portions of the record below.

amended, and common law fraud.[3] The gravamen of his complaint is that respondents improperly conspired to cause conversion of the Class B Common Share without returning WUC to operating profitability.

Petitioner concedes that the Conversion Test for the Class B Common Share, which was fully disclosed in WUC's filings with the Securities and Exchange Commission, permitted conversion without WUC attaining operating profitability. (A-14 to A-15) Nevertheless, petitioner argues, he and the market were misled into believing that the conversion of the Class B Common Share would be predicated on WUC's return to operating profitability, *i.e.*, that there could be no conversion of the Class B Common Share unless the net income to satisfy the Conversion Test had been provided by operating profits. (A-5 to A-6) Petitioner's theory is premised on an alleged "secret plan" to write down assets excessively and subsequently sell those assets at fair value, thereby creating extraordinary gains and paper profits to satisfy the Conversion Test. (A-6)

Treating *seriatim* each alleged misstatement or omission which purportedly promised a return to operating profitability before the Class B Common Share could be converted, the district court found that none were actionable under the federal securities laws. (A-15 to A-20, A-24 to A-27) In particular, the court unequivocally found that petitioner "failed to produce evidence of misstatements to support a section 10(b) claim" (A-20) and "failed to show any omission" (A-25).

The district court also expressly rejected Heil's "secret plan" theory as unsupported by any evidence: "[o]ther than conclusory allegations, Heil has failed to produce any evidence that respondents formulated an intention to satisfy the

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[3] Petitioner's request for declaratory relief under Exchange Act § 14(a) and his claim for breach of fiduciary duty, also included in his complaint, were dismissed by order of the district court on January 13, 1993. That order has not been appealed.

conversion test through paper profits rather than operating earnings." (A-26 to A-27)

On reconsideration, the district adhered to its initial decision.

The United States Court of Appeals for the Second Circuit affirmed the district court's decisions granting summary judgment in favor of respondents and dismissing the complaint. The court of appeals expressly rejected Heil's contention that his allegations regarding the purported "secret plan" are sufficient to defeat summary judgment:

> On appeal, Heil contends that material issues of fact concerning the defendants' alleged omissions, coupled with his unrebutted allegations concerning the defendants' purported "plot" to manufacture paper profits so as to seize control of Western Union under the agreement, precluded the entry of summary judgment. We disagree, for substantially the same reasons offered by the district court [i]n its well-reasoned opinion granting summary judgment.

(A-39)

ARGUMENT

I. IN GRANTING SUMMARY JUDGMENT THE DISTRICT COURT PROPERLY APPLIED *CELOTEX*, *ANDERSON* AND *MATSUSHITA* TO SHIFT THE BURDEN OF PROOF TO PETITIONER

In seeking a writ of certiorari, petitioner argues that the district court misperceived the standards elucidated in this Court's 1986 trilogy of summary judgment decisions.[4] Under those holdings, the evidentiary burden shifts to the

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[4] *Celotex Corp. v. Catrett*, 477 U.S. 317 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

non-moving party as to those items on which the movant has pointed out an absence of evidentiary support. Petitioner suggests there was error below because the district court purportedly shifted the evidentiary burden to petitioner as to *all* elements of his claim. (Pet. at 6)[5]

Petitioner's hypothesis about the district court's actions is incorrect; indeed, it finds absolutely no support in any part of the opinions of the district court or the court of appeals, which opinions show that the courts considered only those elements of petitioner's case which respondents had shown to be deficient.

Respondents introduced evidence to show that the misstatements and omission which petitioner alleged concerning the Conversion Test simply did not exist. After considering the evidence petitioner introduced in response, the district court found, adversely to petitioner, that respondents had *not* represented that conversion of the Class B Common Share was conditioned upon a return to operating profitability. The district court also found, adversely to petitioner, that respondents had *not* omitted to state that net income to satisfy the Conversion Test could be derived from extraordinary or non-operating sources as well as operating sources, but had in fact made amply clear that income from all sources was acceptable.

With the preponderance of petitioner's argument thus disproven by the text of the district court's opinion, there remains only petitioner's contention that he should not have been required to offer any proof with respect to the existence of an alleged "secret plan." Implicit in this argument is the "factual" contention that respondents introduced no evidence in the district court to negate the existence of the alleged "secret plan," so that "legally" petitioner was entitled to rest in this regard on the conclusory allegations of his complaint.

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[5] References in this form are to Heil's Petition for Writ of Certiorari.

Both elements of this formulation are flawed. On the facts, respondents showed the district court that the asset write-downs occurred and were disclosed in 1988, before petitioner purchased his WUC shares, and that, according to his answers to interrogatories, petitioner could not specify a single WUC asset that was written down excessively. Petitioner offered no contrary evidence on the summary judgment motion, and thus failed to show that the "secret plan" caused WUC to meet the Conversion Test. In addition, respondents showed that the extraordinary earnings in 1990 which allowed WUC to meet the Conversion Test arose from the retirement of debt at a discount, rather than from the sale of assets previously written down, and that such assets as were sold in 1990 at a profit were not assets that had been previously written down. Thus, it is incorrect for petitioner to suggest that respondents did not point out the insufficiency of petitioner's evidence regarding the "secret plan."

Moreover, even if respondents had made no such showing to the district court, petitioner would have in any event borne the burden to come forward with evidence to support his allegation of a "secret plan." In light of respondent's showing that there was adequate disclosure that the Conversion Test could be satisfied by operating or non-operating earnings, the burden shifted to petitioner to show -- if he could -- that this disclosure was misleading because respondents in fact intended to satisfy the Conversion Test using only non-operating earnings. Petitioner offered no proof to this effect -- because he had none.

Thus, contrary to petitioner's assertions, under *Celotex*, *Anderson* and *Matsushita*, petitioner bore the burden of proof with respect to each element of his claim on which the district court found his evidence to be deficient, and there was no error in imposing this burden upon him.[6]

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[6] In effect, the "substance" of petitioner's position is that he disagrees with the district court's evaluation of his evidence. The instant petition for a writ of certiorari, asserts nothing more than a purported misapplication of

(Footnote continued)

II. THE DISTRICT COURT PROPERLY FOUND THAT PETITIONER FAILED TO MEET ITS BURDEN OF ESTABLISHING A MATERIAL MISSTATEMENT OR OMISSION UPON WHICH A REASONABLE INVESTOR WOULD RELY

Criticizing the result below, petitioner complains that

> defendants [did] not produce[] any evidence refuting the material allegations of the complaint that defendants (1) omitted to state that the [Conversion Test] could be satisfied by extraordinary earnings, and (2) misled the market into believing that Western Union would have to be returned to profitability before the share could be converted.

(Pet. at 5)

Petitioner argues that respondents had the burden on summary judgment of *negating* petitioner's unsupported allegations. As the district court recognized, however, this Court has expressly held that the position thus advanced by petitioner here is incorrect, stating: "we find no express or implied requirement in Rule 56 that the moving party support its motion with affidavits or other similar matters *negating* the opponent's claim." *Celotex*, 477 U.S. at 323 (emphasis in original).

Petitioner asserts that respondents' "entire argument was simply that since 'net income' technically encompassed extraordinary earnings, the test was literally true." (Pet. at 4) While this is a gross oversimplification, the fact is that when interpreting an objective financial test specifically phrased in terms of generally accepted accounting principles ("GAAP"), the "technicalities" are all-important. Respondents' proof on this issue was not limited, however, to a showing from

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a properly stated rule of law, and accordingly should not be granted. *See* S. Ct. R. 10.

authoritative sources of the meaning of the term "net income" under GAAP. Respondents also showed that this facet of GAAP's operation was revealed in WUC's public filings, including the proxy statement and prospectus in which the Conversion Test was described, and including WUC's 1988 Annual Report. (A-25 to A-26) Although it was not their burden, respondents conclusively established that they had completely and accurately disclosed the fact that the Conversion Test could be satisfied through operating and non-operating income.

The burden on the summary judgment motion thus shifted to petitioner. The district court properly found, after carefully considering all of the evidence offered by petitioner,[7] that petitioner had shown no actionable misrepresentation or omission regarding the conversion of the Class B Common Share (A-17 to A-20, A-25 to A-27) -- without which petitioner's case failed as a matter of law.

In addition, in its opinion granting summary judgment in favor of respondents, the district court expressly considered petitioner's theory that respondents embarked upon a "secret plan" to convert the Class B Common Share without returning WUC to operating profitability, and correctly found that petitioner had failed to offer any proof to support this theory. (A-3, A-6, A-26 to A-27)

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[7] In response to respondents' interrogatories, petitioner failed to identify any claimed misleading statement other than the Conversion Test.

CONCLUSION

For the foregoing reasons, respondents respectfully request that the petition for writ of certiorari be denied.

Respectfully submitted,

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